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UNCLAS SECTION 01 OF 04 JAKARTA 003347

SIPDIS

SENSITIVE  
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DEPT FOR EAP/MTS, EAP/RSP AND EB/IFD/OMA  
TREASURY FOR IA-BAUKOL, OTA-MCDONALD  
DEPT PASS USTR FOR WEISEL  
SINGAPORE FOR TREASURY-BAKER  
COMMERCE FOR 4430-BERLINGUETTE  
DEPARTMENT PASS FEDERAL RESERVE SAN FRANCISCO FOR TCURRAN  
DEPARTMENT PASS EXIM BANK

E.O. 12598: N/A

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SUBJECT: INDONESIA - FINANCE MINISTER REFORMS DEBT MANAGEMENT,  
CUSTOMS, CIVIL SERVICE

REF: A) JAKARTA 3296 - Capital Markets;

B) JAKARTA 3338 - Tax Reform

¶1. (SBU) Summary: Finance Minister Mulyani has achieved notable progress in 2007 in debt management and capital markets supervision. She is also leading a pilot project on civil service reform, by tripling salaries for her Ministry and introducing performance standards. Efforts at the Directorate of Customs, however, are less successful, as customers continue to encounter delays and corruption. Parliament members noted they want to see greater efficiency from the Ministry of Finance (MOF) before rolling out increased salaries more broadly to other agencies. Despite challenges, Mulyani's dynamic Ministry has achieved a lot in 2007, and become an example for others in the Government of Indonesia (GOI) to follow. End Summary.

#### Finance Minister Leading Reforms

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¶2. (SBU) Finance Minister Mulyani, the most dynamic reformer in the GOI, has been using bilateral and multilateral assistance strategically to assist in her internal reforms at the Ministry of Finance. She is cleaning up important directorates and improving performance and transparency, including the Directorate General for Tax (reftel B). Reforms in the Directorate for Debt Management (DMO), and in the Capital Markets and Financial Institutions Supervisory Authority (BAPEPAM-LK) have been big successes in 2007. Progress in Customs is less impressive thus far.

#### Debt Management, Bond Market Deepening

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¶3. (SBU) Capital market development has been a priority for the Ministry of Finance (MOF) and much progress has been made over the past two years. The most notable change has been in debt issuance and management. The GOI's decision to meet a greater portion of its funding requirements domestically through the expanded issuance of government debt has dramatically reduced Indonesia's dependence on hard currency loans and donor finance, lowering its foreign exchange exposure and making the country less vulnerable to exogenous shocks.

14. (SBU) Mulyani's goal was to broaden and deepen the variety of debt instruments and the investor base. An Treasury Department Debt Advisor is currently in place providing technical assistance to support these goals. The MOF implemented a primary dealer system for government securities in the first quarter of 2007. The DMO held the first of several T-Bill auctions in May. ORI's or retail bonds, a class of securities specifically targeting small retail investors, can now be purchased via subscription through a variety of banks nationwide, making them more available. A withholding tax was applied to the T-Bills, which caused problems for a number of investors, but the auctions continue to be over-subscribed. The Ministry of Finance is aware that it currently lacks a rational and consistent approach for tax treatment of securities, and plans to address this in 2008 (reftel A).

15. (SBU) An efficient T-Bill market is an important component of the capital market development program. Short-term instruments could become an important source of funding and allow the GoI to meet its financial obligations in the event of a financial crisis. As Treasury Advisor to DG Debt Management William Cotter notes, "In the event of a crisis, investors won't buy 30-year bonds but will actively seek refuge in T-Bills."

#### Foreign Ownership of Bonds Climbs

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16. (U) Despite the volatility in global markets in August 2007, investors continue to buy Indonesia's bonds. According to a report by Citibank and the Director General for Debt Management, the number of non-resident bond holders of Indonesian sovereign debt has increased dramatically in the past two years. The amount of debt in foreign hands has increased from Rp 26 trillion (\$2.7 billion) in 2005 to Rp 80 trillion (\$8.6 billion) in mid-2007. The amount of

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foreign investment in debt with maturity over ten years is now half of the total held by foreigners, versus almost none in late 2004.

#### Government Bond Futures, Derivatives

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17. (SBU) With the recent merger of the Jakarta and Surabaya Stock Exchanges into the Indonesia Stock Exchange (Bursa Efek Indonesia or BEI), Treasury's OTA Advisor William Cotter is assisting at the request of the Chairman of the Capital Markets and Financial Institutions Supervisory Agency (BAPEPAM-LK) in development of a government bond futures market. The MOF fully supports the contract and clearing specifications, which are in the final stages of development, and hopes eventually to launch a T-Bill contract on the new exchange once the outstanding volume of bills is large enough to support trading.

18. (U) Although MOF, BI, and BAPEPAM-LK have made a number of individual efforts to generate activity in the repo market, there has been little progress until recently (see reftel A). Both BI and the MOF acknowledge the benefits of such market, but were reluctant to collaborate and to lead the efforts in stimulating this sector. The MOF now hopes to make progress towards a repo market as a project priority in 2008.

#### Customs Reform

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19. (U) The Finance Ministry, on July 1, 2007 began rolling out its latest bureaucracy reform program, based on two ministerial decrees issued late June 2007. It includes improving, by the end of 2008, 6,475 public service procedures related to the ministry, with 35 of them being top priorities for reform. Sixteen of the priority public service procedures are within the tax and customs office. The Directorate General for Customs and Excise support is increasing public participation in the regulatory process by permitting media and public participation and comment.

Cleaning up Tanjung Priok,  
Indonesia's Largest Port

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¶10. (U) Mulyani began with an overhaul of customs at Tanjung Priok, Indonesia's largest seaport near Jakarta, launching the Customs Main Service Office (KPU), a merger of four custom offices, in Tanjung Priok. This reform aims to reduce delays and bureaucracy. The KPU will serve same services as they provided in the past for export-import processing at the port. New customs officials must pass a competency test conducted nationwide for customs officers. Goals for improved services at Customs and Excise include:

--The processing of "priority lane" imported goods at ports within a minimum 20 minutes and a maximum four hours.

--The processing of "green lane" imported goods within 20 minutes.

--The processing of "red lane" imported goods within four hours.

--The processing of "rush handling" imported goods within 120 minutes.

--The processing of exported goods within a minimum one hour and a maximum four hours.

--The processing of customs payment refunds within 30 days, and customs payment complaints within 60 days.

--The processing of notices on specific imported goods within a day.

...But Problems Continue  
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¶11. (SBU) Starting with Indonesia's largest seaport, moving 80% of goods into and out of the nation sends a symbolic message that Mulyani is cleaning house. On the ground, however, users are still encountering problems and say clearances still take days instead of hours. A 2007 survey of 589 manufacturing firms in five metropolitan areas by the Institute for Economic and Social Research (LPEM) showed that from 2005 to 2007, red lane goods clearance had

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been reduced from 7.6 days to 6.1, and green lane goods from 6.1 to 3.1. However, 38% of companies in 2007 (versus only 20% in 2005) reported paying bribes "occasionally" for services. Another problem is that the USG, the EU and others have experienced major delays in diplomatic shipments in recent months. Customs is allegedly requiring closer inspection due to smuggling, fraudulent classification of goods, and abuse and counterfeiting of diplomatic permits. One shipper told us that until MOF standardizes and cleans up customs procedures at all seaports, graft and smuggling will opportunistically move to nearby facilities with less scrutiny.

¶12. (SBU) A new regulation (P-25/BC/2007) on goods classification (low, medium and high risk) issued August 2007 was intended to expedite the clearance process, with low risk, 10% of goods are subject to physical inspection; high risk means 100%. EU contacts told us that European shippers of food products find they are still being targeted for delays and informal facilitation fees. Customs plans to roll out the National Single Window (NSW) in the second quarter of 2008, related to the ASEAN Single Window initiative. Underway is a NSW pilot project in Tanjung Priok to be completed by year end, with four (out of 37) agencies involved in the goods clearance process.

No More Moonlighting: Civil Service Reform  
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¶13. (SBU) Many GOI officials in the past "moonlighted" working 2-3 jobs to compensate for low salaries (reftel A). One official at the State Audit Board (BPK) said that he served as a consultant in the evening and taught university courses on the weekend to make ends meet. Other high-ranking officials serve on Boards of Commissioners for state-owned enterprises, earning large additional fees and salaries. There are obvious conflicts of interest in the GOI owning and advising firms which it is also regulating. President Yudhoyono placed the Finance Ministry among the top priorities for bureaucratic reform, along with the Supreme Court and Supreme Audit Board (BPK). MOF reform, launched July 2007, is designed as a pilot project for other government ministries and agencies. Acknowledging public and Parliamentary skepticism, Mulyani called

for improved performance from officials at her ministry, which is responsible for managing state finances and 75% of state revenues. "I expect an attitude change from every unit in doing their jobs, and to continue carrying out the reforms we are doing," she said during the swearing-in of two of the ministry's secretariat general officials and 18 customs officials on August 3. "There is a lot of pessimism out there regarding our reform efforts, and we are not in a position to claim a clean slate on our track record."

¶14. (SBU) The Finance Ministry's reform program has attracted controversy, as it involves a increase in benefits totaling Rp 4.3 trillion (\$477 million) for its some 62,000 civil servants, ranging from Rp 1.3 million to Rp 46 million for high-ranking officials. Mulyani argued for the raise, saying it would help maintain professionalism and prevent graft among the Ministry's officials. "Without the increase, employees with high performance are underpaid and tempted by the private sector," she said. "There have been cases in which some officials became very rich from unknown sources. In another case, a tax official we just trained and funded to study abroad was, within two months, hired as a consultant by the company whose taxes he had just assessed."

¶15. (U) Reforms at the Ministry's Directorate General for State Treasury include the processing of all project proposals and assessments within 20 days after details of the state budget have been issued, and fund disbursements within an hour after a project has been approved. The Capital Markets and Financial Institutions Supervisory Agency (BAPEPAM-LK) should process the registration of any new, publicly-listed company within 45 days.

#### Not Yet Institutional Reform

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¶16. (SBU) Marsillam Simanjuntak, former Attorney General and current Presidential Advisor, said that the moonlighting issue underlies a larger institutional problem of meager salaries for government

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officials. Simanjuntak said that the Rp 5 trillion budget increase for Ministry of Finance salaries is provisional only for one year: this is not yet institutional reform, he stated. Offering competitive salaries and improving performance for government officials across all agencies remains a major future challenge.

#### DPR Wants to See Greater Efficiency from Higher Salaries

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¶17. (SBU) In a meeting with Parliamentarians from Commission XI (Finance, Budget and Banking) on December 3, DPR Members said that they expect to see greater efficiencies from the increased salaries at MOF. "Before we roll out on a wider basis, we really want to see improved performance." Minister Mulyani has introduced key performance indicators for every position in the Ministry of Finance and is strengthening and regularizing requirements for advancement. In addition, she has empowered the function of the Ministry's Inspector General to investigate misconduct. But DPR members clearly want to assert the power of the purse and make the salary increases conditional.

#### Donors Helping Mulyani's Transformation in Several Areas

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¶18. (SBU) In addition to those mentioned above, USAID is funding other advisors at the Ministry of Finance. USAID assisted the MOF to improve fiscal policies, accelerate public sector debt restructuring, and reform tax policies. Efforts to strengthen the public sector debt restructuring process were done by improving capacity and implementation of the MoF's policy at the Asset Management Company (PPA), and improving development and implementation of the MoF's risk management and restructuring capabilities. Major achievements include the debt restructuring of Garuda and Merpati, two of the largest national Indonesian airlines. USAID and Treasury OTA also coordinate effectively with other donors: AUSAID has advisors at the Fiscal Policy Office, the IMF at

DG Tax (reftel B), and the World Bank in several directorates under its Government Financial Management and Revenue Administration Project (GFM-RAP) program.

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